



Order 97-1-17

**UNITED STATES OF AMERICA
DEPARTMENT OF TRANSPORTATION
OFFICE OF THE SECRETARY
WASHINGTON, D.C.**

Served: January 30, 1997

Issued by the Department of Transportation
on the 24th day of January, 1997

U.S.-Philippines All-Cargo
Service Proceeding

Docket OST-96-1074

FINAL ORDER

By this order, we make final our tentative grant of authority to Polar Air Cargo, Inc. (Polar) and United Parcel Service Co. (UPS) to provide scheduled all-cargo services in the U.S.-Philippines market.

Background

Under the provisions of the 1995 Protocol to the U.S.-Philippine Air Transport Services Agreement, the United States may now designate two additional carriers to provide scheduled all-cargo services on Route 3 of the Agreement.¹ By Order 96-2-19, we instituted the above-captioned proceeding to select those two carriers. That order describes the major selection criteria as: (1) which applicants will be most likely to offer and maintain the best service for the shipping public; (2) the effect of the applicants' service proposals on the overall market structure and level of competition in the U.S.-Philippines cargo market, and any other markets shown to be relevant, in order to promote an air transportation environment that will sustain the greatest public benefits; and (3) other factors historically used for carrier selection where they are relevant.

Five carriers, Evergreen, Northwest, Polar, UPS, and World, applied for the two available designations. By Order 96-11-7, served November 19, 1996, the Department tentatively determined that the selection of Polar and UPS most effectively satisfies the selection criteria in this case. Specifically, the Department

¹ Route 3 reads "from the United States via intermediate points to the Philippines and beyond." Federal Express Corporation is the only carrier currently designated on Route 3.

found that, among the five applicants, UPS is the only carrier offering comprehensive, integrated express/small package service plus general air freight service, and was therefore most likely to offer and maintain the best service for the shipping public.² In addition, the Department found that the selection of UPS would have the most beneficial impact on the overall market structure and level of competition in the U.S.-Philippines cargo market by providing the strongest and broadest competition to the incumbent, FedEx, an integrated all-cargo carrier.³

Having tentatively determined to select UPS, the Department also tentatively concluded that, among the four remaining applicants, Polar, with five roundtrips per week, offers significant new capacity in the U.S.-Philippines cargo market through its B-747 wide-body service, giving U.S.-Philippines shippers the aircraft with the largest available lift. The Department further determined that Polar offers the most single-plane service to/from the U.S. points with the greatest amount of U.S.-Philippines traffic of any of the applicants.⁴

Interested parties were directed to show cause why we should not make grant of authority to Polar and UPS final. Objections to the tentative findings and determinations were filed with the Department by Evergreen, Northwest, and World. Answers to Objections were filed by Polar and UPS.

Summary of Objections

Evergreen

In its Objection, Evergreen states that it does not object to the tentative selection of UPS. However, it believes that the comparative analysis of Polar's and Evergreen's proposals in Order 96-11-7 is "substantially flawed."⁵ Specifically, Evergreen argues that Polar is not proposing to offer any new trans-Pacific capacity to serve the Philippines, but that it is proposing only to make Manila a stop on its existing services. Citing the percentages of existing Polar capacity that Polar forecasts would be utilized in the U.S.-Philippines market, Evergreen argues that Polar's proposal is designed to serve the U.S.-Taiwan and U.S.-Singapore markets, which are both open-entry markets.⁶

Evergreen states that its proposal offers significant new Trans-Pacific capacity in the form of two new weekly B-747 flights between San Francisco and the Philippines, the capacity of which would be nearly entirely dedicated to the U.S.-Philippines market. Taking issue with the reference in Order 96-11-7 to the fact that two of

² Order 96-11-7, at 5-6.

³ *Id.*, at 6.

⁴ *Id.*

⁵ Objection of Evergreen, at 1.

⁶ *Id.*, at 3.

Evergreen's South Pacific flights are wet-leased by Qantas, Evergreen stated that it anticipates entering into a codeshare arrangement with Qantas pursuant to which Evergreen will hold out U.S.-Philippines service and carry U.S.-Philippines traffic.⁷

Citing its experience and commitment in Asia/Pacific markets, Evergreen argued that adding the Philippines to its existing U.S.-Asia/Pacific network would significantly enhance the competitive structure of the market. Not selecting Evergreen, it argues, would unduly restrict competition in Asia/Pacific cargo markets to Polar, FedEx, and UPS.

Northwest

In its Objection, Northwest states that its commitment to the U.S.-Philippines market is well demonstrated by the fact that it has initiated service using the three weekly frequencies temporarily reallocated from United Airlines by Order 96-10-16. Although recognizing Department policy against permitting carriers to modify their service proposals at this late stage in contested route cases, Northwest urges the Department to consider its current operations using the reallocated United frequencies as well as its willingness immediately to offer a fourth weekly U.S.-Philippines all-cargo flight if selected.⁸ At a minimum, Northwest urges the Department to find another avenue to enable Northwest to continue to operate its existing three weekly U.S.-Philippines all-cargo flights on a permanent basis.⁹

World

In its objection, World argues that UPS will duplicate service already available from FedEx, at the expense of introducing additional meaningful competition in the underserved freight-all-kinds market.¹⁰ World argues that UPS proposes to operate the smallest aircraft among the applicants, B-767's, which offer significantly less capacity than World's DC-10-30 and MD-11 equipment. World also argues that Polar's service proposal is inferior to its own, discounting, as World does, Polar's traffic data, which it views as "vastly inflated."¹¹ World goes on to argue that in view of Polar's and UPS's authority to serve the Japan all-cargo market, the selection of those two carriers in this proceeding will increase the overall level of concentration in Pacific.

World also argues that Order 96-11-7 "grossly mischaracterizes" its application.¹² Alleging that the Department apparently misunderstood the nature of the

⁷ *Id.*, at 4.

⁸ Objection of Northwest, at 3.

⁹ *Id.*

¹⁰ *Id.*, at 2.

¹¹ *Id.*, at 4.

¹² *Id.*, at 6.

cooperative arrangements with Malaysian Airlines and Asiana Airlines that form a part of World's service proposal, World argues that its proposed arrangement with Asiana would provide for the remarketing by Asiana of an unspecified portion of the aircraft's capacity, but that World would retain the right to sell "any capacity unused by Asiana."¹³

World also asserts that the Department misunderstands the nature of its relationship with MAS; it argues that the two carriers are parties to a codeshare arrangement and by placing its 'WO' code on the flight, World retains the right to market the service as its own.¹⁴ World finally argues that the Department's "hostile reaction" to the World/MAS arrangement stands in marked contrast to the Department's policy on passenger code-share operations, which have received our "express encouragement."¹⁵

Summary of Answers to Objections

Polar

In its Answer, Polar asserts that no other applicant in the proceeding would or could provide the scope of benefits that would flow from Polar's designation to serve the U.S.-Philippines market. Polar argues that Evergreen's traffic forecast is unsupported by credible evidence and should not be given credence.¹⁶ Noting that two of Evergreen's three proposed weekly South Pacific frequencies are tied directly to wet-lease operations conducted by Evergreen for Qantas, Polar argues that the record does not include any representations from Qantas that would support Evergreen's claim that it anticipates Qantas would allow it to carry U.S.-Philippines cargo on those flights.¹⁷

The real risk in Evergreen's proposal, however, Polar argues, is that "the continuation of Evergreen's entire service to and from the Philippines is entirely dependent upon maintaining its wet-lease and code-share arrangements with Qantas."¹⁸ Finally with regard to Evergreen, Polar argues that Evergreen fails to address how its failure to obtain authority in the *Hong Kong Fifth-Freedom All-Cargo Proceeding* affects the viability of Evergreen's service proposal in this proceeding.

Polar argues that World, like Evergreen, is essentially a carrier engaged in charter and wet-lease activities. Polar argues that World's objection, centering on an analysis of the size of the markets that World proposes to serve on a direct basis,

¹³ *Id.*

¹⁴ *Id.*, at 8.

¹⁵ *Id.*

¹⁶ Answer of Polar, at 3-4.

¹⁷ *Id.*, at 4.

¹⁸ *Id.*, at 4-5.

ignores the fact that World would serve the largest U.S.-Philippines market, New York, only once a week and with an aircraft significantly smaller than Polar's B-747F.¹⁹ Polar further argues that World's relationships with Asiana and MAS would likely preclude World from controlling all of the capacity on its flights and, in any event, results in World's limited capacity being susceptible to being reduced by the requirements of World's foreign marketing partners.²⁰

With regard to Northwest's Objections, Polar answers that Northwest should not be allowed to modify its service proposal and thereby further delay the award of authority in this proceeding.

UPS

In its Answer, UPS argues that an award to UPS best meets the decisional criteria in this proceeding because UPS, among the applicants, will offer and maintain the best service to the shipping public, and will do the most to enhance the overall market structure and level of competition in the U.S.-Philippines cargo market.²¹ UPS argues that it is the only applicant offering both integrated express/small package and general air freight service and is therefore the applicant that can provide the strongest and broadest competition to the incumbent FedEx.²²

UPS also argues that the selection of UPS, with its emphasis on serving the express/small package market, in combination with an applicant serving the general air freight segment of the market, provides the best and broadest range of service options for shippers. In addition, UPS argues that it can offer the greatest range of services over the largest transportation network with the greatest geographic coverage of any of the applicants and, with its large fleet of diverse size aircraft, it can add or delete capacity in small increments.²³

Asserting that Northwest, like Evergreen, does not object to the selection of UPS, UPS goes on to object to Northwest's proposal that it be allowed to modify its service proposal at this stage of the proceeding. UPS argues that Northwest can already carry belly cargo on its existing B-747 combination service, and that Northwest can convert any of its Route 2 frequencies to all-cargo frequencies at any time.²⁴ Finally, with regard to Northwest, UPS argues that Northwest will be eligible to receive new Route 2 authority that will be available in October, and that

¹⁹ *Id.*, at 8.

²⁰ *Id.*, at 8.

²¹ Answer of UPS, at 1-2.

²² *Id.*, at 3.

²³ *Id.*, at 5-6.

²⁴ *Id.*, at 9.

Northwest already has a significant amount of limited entry route authority in the major Pacific markets.²⁵

UPS argues that World, by arguing that UPS's service would duplicate service already provided by FedEx, actually confirms the fact that only UPS would be fully competitive with FedEx. UPS states that competition is an important public benefit that should be given significant decisional weight.²⁶ UPS takes issue with World's argument that the selection of UPS would do nothing for the competitive needs of the "freight-all-kinds" market, asserting that it submitted substantial, uncontroverted evidence that it provides highly competitive service in all segments of the market.

Noting that World argues UPS's service would be inferior because of "multiple transfers and interminable transit times," UPS answers that World would serve the largest U.S.-Philippines market, New York, only one day per week and would serve Los Angeles and San Francisco with only two flights per week.²⁷ UPS goes on to argue that World's arrangements with Asiana and MAS may alone warrant the denial of World's application; without knowing the full details of World's contracts with these two carriers, UPS argues that the Department is not in a position to know whether an award to World in this proceeding would effectively be an award of limited-entry route authority to foreign carriers.²⁸

UPS also takes issue with World's complaint that the aircraft UPS would use, B-767's, are the smallest aircraft proposed in this proceeding, arguing that by operating these aircraft over the routes proposed, UPS will attain acceptable load factors, even with six weekly frequencies, thereby assuring the economic viability of the service and UPS's ability to maintain it.²⁹ UPS, like Polar, also asserts that World is a contract/charter operator, not a scheduled cargo carrier, and should not be awarded a limited-entry designation on a scheduled route.³⁰

Decision

None of the objections raised persuades us to alter our tentative findings and conclusions in this proceeding. For the reasons set forth below, we find that among the five applicants, UPS and Polar are the two carriers most likely to offer and maintain the best service for the shipping public while having the most beneficial effect on the overall market structure and level of competition in the U.S.-Philippines cargo market. We also find that the selection of UPS and Polar in this

²⁵ *Id.*, at 10.

²⁶ *Id.*, at 11.

²⁷ *Id.*, at 12.

²⁸ *Id.*

²⁹ *Id.*, at 12-13.

³⁰ *Id.*, at 14.

proceeding will promote an air transportation environment that will sustain the greatest overall public benefits.

UPS is the only carrier offering comprehensive, integrated express/small package service plus general air freight service, thereby enabling it to provide the most meaningful competition to the incumbent, FedEx, an integrated all-cargo carrier. As we stated in Order 96-11-7, the selection of UPS, with its emphasis on serving the express/small package market, in combination with any of the other applicants stressing general air freight will provide the best and broadest range of service options for shippers in the market.

UPS will provide the greatest number of frequencies of the applicants with the smallest aircraft, consistent with its express/small package focus. This service pattern complements the proposals of any of the other applicants, each of which would operate larger, wide-body aircraft designed to accommodate the larger general air freight shipments, but with fewer weekly frequencies. As we tentatively concluded in Order 96-11-7, UPS offers the greatest range of services over the largest transportation network with the greatest geographic coverage of any of the applicants. Since the Agreement has no restrictions on intermediate and beyond points, UPS will be able to integrate its Philippines service with any other point in Asia that it serves.

Because of its fleet size and configuration, UPS can also add or delete capacity in small increments as market conditions warrant. In addition, UPS is the only applicant that can fully and effectively compete with FedEx, a carrier that for many years has been the only U.S. flag all-cargo carrier in the Philippines market, thus furthering the goal of benefiting the overall market structure and level of competition. The fact that UPS will operate relatively smaller aircraft than the other applicants, rather than being a negative factor as World argues, is viewed favorably because, by using smaller aircraft, UPS can operate six weekly frequencies, thereby providing effective service to shippers in the time-sensitive express/small package market.

Having decided to select UPS, we find that, among the remaining four applicants, Polar most effectively satisfies the selection criteria in this case. Polar will offer and maintain the best service for the shipping public while enhancing the overall U.S.-Philippines cargo market structure and maximizing competition. With five roundtrips per week, Polar offers significant new capacity in the U.S.-Philippines cargo market through its B-747 wide-body service, giving U.S.-Philippines shippers the aircraft with the largest available lift.

The fact that Polar will integrate its U.S.-Philippines service into its existing Pacific route structure does not support the conclusion that Evergreen would have us reach, that Polar would introduce no new capacity in the U.S.-Philippines cargo market. An analysis of Polar's exhibits in this regard fully supports the conclusion that Polar

will utilize a significant portion of the capacity on the routes to serve the U.S.-Philippines cargo market, particularly in the eastbound direction, where a significant traffic imbalance exists.³¹ As we stated in Order 96-11-7 in the context of UPS's service proposal, the carriage of some fifth freedom traffic over the proposed route does not militate against an award in this proceeding.³²

Given the developing nature of the U.S.-Philippines cargo market, the carriage of fifth freedom traffic is likely to contribute to the overall success of cargo service between the two countries. Like UPS, Polar's proposal to carry a reasonable level of fifth freedom traffic is not viewed as excessive under the circumstances of this proceeding. In the circumstances of this case, we believe that the capacity that Polar forecasts in its first year is reasonable. Against this background, we do not view Polar's proposal as primarily serving the U.S.-Taiwan or U.S.-Singapore markets, as Evergreen argues.

Among the applicants, Polar also offers the most single-plane service to/from the U.S. points with the greatest amount of U.S.-Philippines traffic. As we noted in Order 96-11-7, three of the top five U.S.-Philippines markets (New York, Chicago, and Anchorage) would receive new U.S.-Philippines single-plane service with at least three flights per week in both directions under Polar's proposal.³³ In the underserved eastbound direction, Polar offers the greatest amount of service; New York and Chicago would each receive four flights per week, and Anchorage would receive five flights per week. Los Angeles, also one of the top five U.S.-Philippines markets, would receive two westbound flights and one eastbound flight. Seattle would also receive new U.S.-Philippines service with one eastbound flight.³⁴

As we concluded in Order 96-11-7, no other proposal provides as much new single-plane service to as many U.S. points. Evergreen would offer new single plane service with three westbound flights per week from New York, Chicago, and Los Angeles, and new single plane roundtrip service from San Francisco twice per week. In the eastbound direction, aside from San Francisco, only New York and Columbus are forecast by Evergreen to receive cargo traffic from the Philippines, with three flights per week in each market.³⁵ World would serve New York, Los Angeles, and San Francisco in both directions, but, significantly, would serve New York, the largest U.S.-Philippines market, with only one roundtrip per week, and would serve Los Angeles and San Francisco with only two flights per week in each market.³⁶

³¹ PO-302.

³² Order 96-11-7, at 6.

³³ Although Polar's proposal shows five westbound flights per week, two of those flights forecast no traffic in the westbound direction.

³⁴ Order 96-11-7, at 7.

³⁵ Although Evergreen proposes to serve Anchorage on its eastbound service, it did not forecast any traffic.

³⁶ Although World proposes to serve Anchorage on its roundtrip service, it did not forecast any traffic

Northwest would serve only Chicago, the fourth largest U.S.-Philippines market, with a single roundtrip flight per week, and would serve Los Angeles and San Francisco in the eastbound direction only with a single flight per week.³⁷

Evergreen and World take issue with Polar's traffic data in this proceeding, as does Polar with theirs. However, despite the allegations, the Department's review of each of the applicants' traffic data leads us to the conclusion that, while each of the applicants' forecasts could be characterized as containing somewhat optimistic projections, none, on whole, were outside the range of normally acceptable forecasting methodologies.

In view of our finding here that Polar's service proposal is superior to those of the remaining applicants, it is not necessary to reach any final determinations regarding the argument raised that Evergreen's and World's cooperative agreements with foreign air carriers limit the competitive benefits of the carriers' proposals as a result of their inability to market all the capacity they propose to introduce. These cooperative agreements were only one part of their proposals. As explained in this order and Order 96-11-7, when looking at the totality of the proposals, the proposal of Polar is superior to Evergreen's, Northwest's or World's proposal. The cooperative agreements of Evergreen and World do not overcome the advantages of Polar's proposal.

We are unpersuaded that the selection of Polar and UPS in this proceeding will restrict competition or increase carrier concentration in the U.S.-Pacific markets, as Evergreen and World argue. On the contrary, we find that the opportunity for Polar and UPS to enter the Philippines cargo market, which has until now been restricted to only one cargo carrier, FedEx, will greatly expand competition in the U.S.-Philippines market specifically, as well as the U.S.-Pacific market generally. With their relatively weaker service proposals, we find that the competitive benefits of Evergreen's and World's proposals would be somewhat less in magnitude. As an incumbent carrier, Northwest already offers substantial belly cargo capacity with its existing B-747 combination service, and its selection therefore does not offer the competitive or market structure benefits of adding another carrier in the U.S.-Philippines cargo market.

Finally, we have determined not to permit Northwest to modify its service proposal at this stage in this proceeding, given the unavoidable prejudice to the other parties, the delay that would result from any attempt to alleviate that prejudice, and in the interest of enabling service to begin as soon as possible. In this regard, we take note of the fact that Northwest will be eligible to receive additional Route 2 frequencies in

eastbound.

³⁷ Although Northwest proposes to serve Anchorage on its roundtrip service, it did not forecast any traffic in either direction.

October of this year, and in any event has the present ability to convert its Route 2 frequencies to all-cargo service.

Dormancy Provisions

As we indicated in Order 96-11-7, a standard 90-day startup requirement and dormancy provision is included in the exemptions that are being issued pursuant to this order.

ACCORDINGLY,

1. We hereby make final our tentative findings and conclusions in Order 96-11-7;
2. We exempt Polar Air Cargo, Inc. from the requirements of 49 U.S.C. Section 41101 and the terms, conditions, and limitations of its certificate of public convenience and necessity to the extent necessary to enable it to provide scheduled all-cargo services between the coterminal points New York, Chicago, Anchorage, Los Angeles, Seattle, and Honolulu, on the one hand, and Manila, Philippines, on the other, via the intermediate points, Khabarovsk, Russia, Auckland, New Zealand, Sydney/Melbourne, Australia, and Singapore, and beyond Manila to Taipei, Taiwan;
3. We exempt United Parcel Service Co. from the requirements of 49 U.S.C. Section 41101 and the terms, conditions, and limitations of its certificate of public convenience and necessity to the extent necessary to enable it to provide scheduled all-cargo services between Anchorage and Manila, Philippines, via Seoul, Korea, and Taipei, Taiwan, and beyond Manila to Singapore and Kuala Lumpur, Malaysia;
4. The authority granted in ordering paragraphs 2 and 3 is effective immediately and shall remain in effect for two years from the date of issuance of this order, provided, however, that the authority of either carrier shall expire if it fails to inaugurate service within 90 days from the issuance of this order, or if it discontinues service for 90 days, or if it notifies the Department that the service is discontinued, unless the Department earlier suspends, modifies, or deletes the authority;
5. Since all parties had an opportunity to comment on our tentative findings and conclusions, we will not entertain petitions for reconsideration; and
6. We shall serve this order on all parties in Docket OST-96-1074.

By:

PATRICK V. MURPHY
Deputy Assistant Secretary for Aviation
and International Affairs

(SEAL)

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